Foundations of MARKETING
Seventh Edition

Chapter 12

An Overview of Strategic Marketing

Pride | Ferrell

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Learning Objectives

12-1 Identify issues related to developing pricing objectives.

12-2 Discuss the importance of identifying the target market's evaluation of price.

12-3 Explain the importance of demand and the price elasticity of demand.

12-4 Describe the relationships among demand cost, and profit relationships.

12-5 Explain how marketers analyze competitors' prices.

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Learning Objectives

12-6 Describe the bases used for setting prices.

12-7 Explain the different types of pricing strategies.

12-8 Describe the selection of a specific price.

12-9 Identify seven methods companies can use to price products for business markets.

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Basis for Competition

- **Price competition** – emphasizes a product's low price and sets a price that equals or beats the competitors' prices
- **Non-price competition** – emphasizing factors other than price to distinguish products through their distinctive features from competing brands

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Discussion Point – Price and Non-price Competition

Source: Mandritoiu/Shutterstock.com

Source: Perry Correll/Shutterstock.com

Generally, soft drink brands compete on the basis of price competition. Some brands of hair care products, such as Biolage, emphasize product quality and compete on a non-price basis.

What products do you buy without comparing prices?

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Figure 12.1 - Stages for Establishing Prices

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Development of Pricing Objectives

Pricing objectives - goals that describe what a firm wants to achieve through pricing

- Form the basis for decisions for other stages of the pricing process
- Must be stated explicitly and in measurable terms
- Should include a time frame for accomplishing them
- Influence decisions in many functional areas of a business

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Pricing Objectives

- Survival
- Profit
- Return on investment
- Market share
- Cash flow
- Status quo
- Product quality

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Discussion Point – Product Quality

Source: Société Cartier

Cartier offers high-quality jewelry and prices its products accordingly.

Do you trust that a higher-priced product is of higher quality?

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Assessment of the Target Market's Evaluation of Price

- The importance of price varies depending on
  - The type of product and target market
  - The purchase situation
- Assessment helps marketers decide the emphasis on price in the overall marketing strategy.
- Manufacturers focus on the value of products in communications with customers as consumers shop more selectively.

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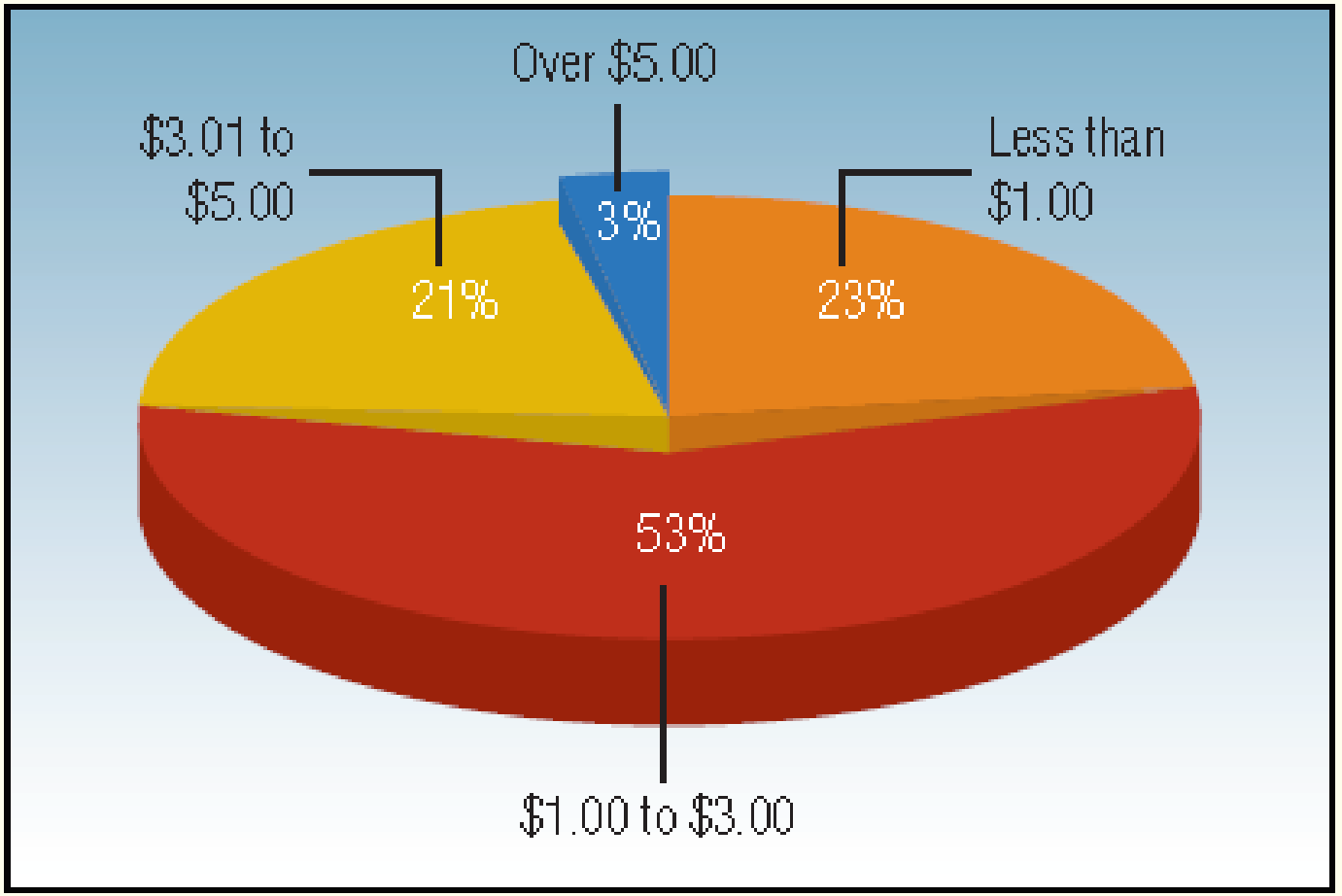
How Much Does a Good Cup of Coffee Cost?



SNAPSHOT

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Demand Curves

Demand curve – a graphic representation of the quantity of products expected to be sold at different prices holding other factors constant

- Demand is inversely related to price for most products
- Demand depends on factors in the marketing mix
  - Quality
  - Promotion
  - Distribution
- Not all types of demand conform to the demand curve

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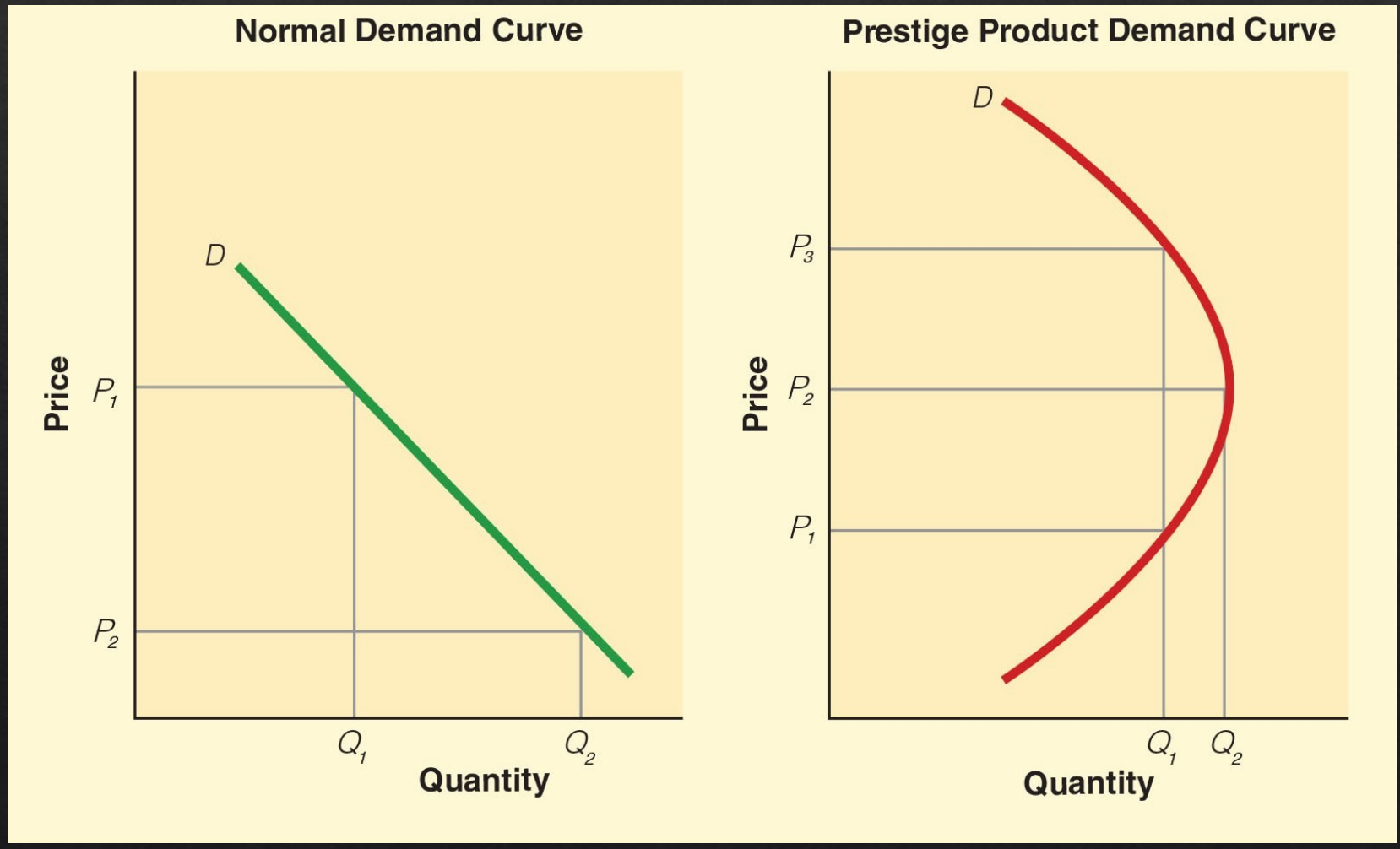
Figure 12.2 - Demand Curve Illustrating the Typical Price/Quantity Relationship



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Demand Fluctuations

- Factors that can influence demand
  - Changes in buyers' needs
  - Variations in the effectiveness of other marketing mix variables
  - Presence of substitutes
  - Dynamic environment
- Organizations can develop new products and prices anticipating demand fluctuations

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Assessing Price Elasticity of Demand

Price elasticity of demand – a measure of the sensitivity of consumer demand for a product or product category to changes in price

- Elasticity - percentage change in quantity demanded relative to a given percentage change in price
- Determine price elasticity of demand – easier o set a price

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Assessing Price Elasticity

- Marketers can determine whether a product is price elastic by analyzing total revenues as prices change
  - Elastic demand - change in price causes and opposite change in total revenue
  - Inelastic demand - total revenue changes in the same direction
- Formula determining the price elasticity of de

$$\text{price elasticity of demand} = \frac{\%\ \text{change in quantity demanded}}{\%\ \text{change in price}}$$

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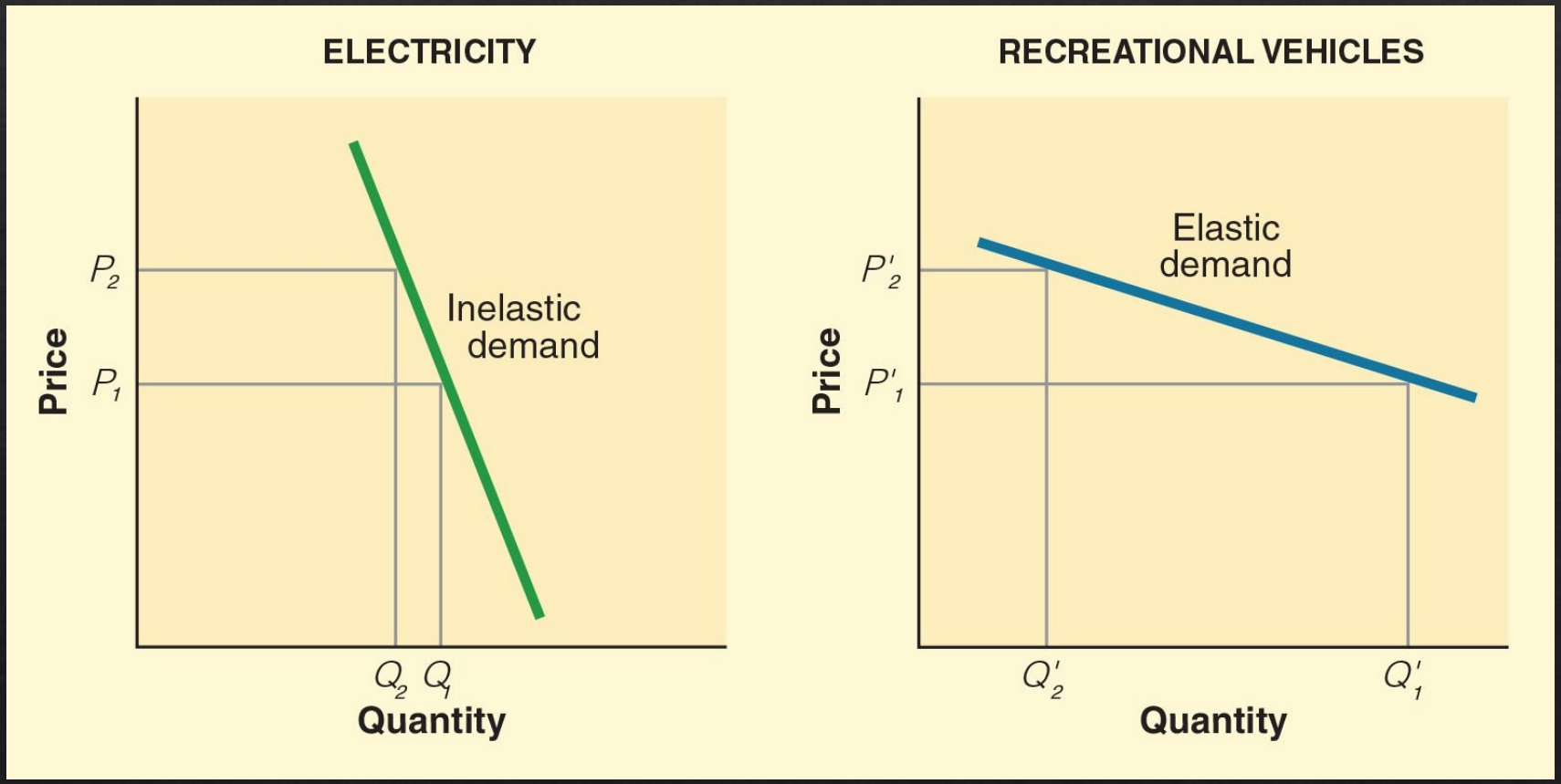
Figure 12.3 - Elasticity of Demand



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Discussion Point – Price Elasticity of Demand

Source: Laura Gangi Pond/Shutterstock.com

Gasoline is an example of a product that has inelastic demand. When the price of gasoline goes up, consumers do not significantly reduce consumption. When the price goes down, consumers do not significantly increase their consumption.

Does the price of gasoline impact your road trips?

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Demand, Cost, and Profit Relationships

Customers

- Less tolerant of price increases

Companies

- Find ways to maintain high quality and low costs
- Prices must cover costs
- Prices must meet customers' expectations

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Marginal Analysis

- Marginal analysis - examines what happens to a firm's costs and revenues when production changes by one unit
- Types of potential costs
  - **Fixed costs** - do not vary with changes in the number of units produced or sold
  - **Average fixed cost** - fixed cost per unit produced
  - **Variable costs** - vary directly with changes in the number of units produced or sold
  - **Average variable cost** – costs vary directly with changes in number of units produced

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Marginal Analysis (continued)

- **Total cost** – the sum of average fixed and average variable costs times the quantity produced
- **Average total cost** – the sum of the average fixed cost and the average variable cost
- **Marginal cost (MC)** – the extra cost incurred by producing one more unit of a product

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Table 12.1 - Costs and Their Relationships

1 Quantity	2 Fixed Cost	3 Average Fixed Cost (2) ÷ (1)	4 Average Variable Cost	5 Average Total Cost (3) + (4)	6 Total Cost (5) × (1)	7 Marginal Cost
1	$40	$40.00	$20.00	$60.00	$50	
						$10
2	40	20.00	15.00	35.00	70	
						2
3	40	13.33	10.67	24.00	72	
						18
4	40	10.00	12.50	22.50	90	
						20
5	40	8.00	14.00	22.00	110	
						30
6	40	6.67	16.67	23.33	140	
						40
7	40	5.71	20.00	25.71	180	

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Marginal Revenue

- Marginal revenue (MR) – the change in total revenue resulting from the sale of an additional unit of product
- Offers little help in pricing new products
- Marketers can benefit by understanding the relationship between marginal cost and marginal revenue in setting prices of existing products.

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Figure 12.4 - Typical Marginal Cost and Average Total Cost Relationship

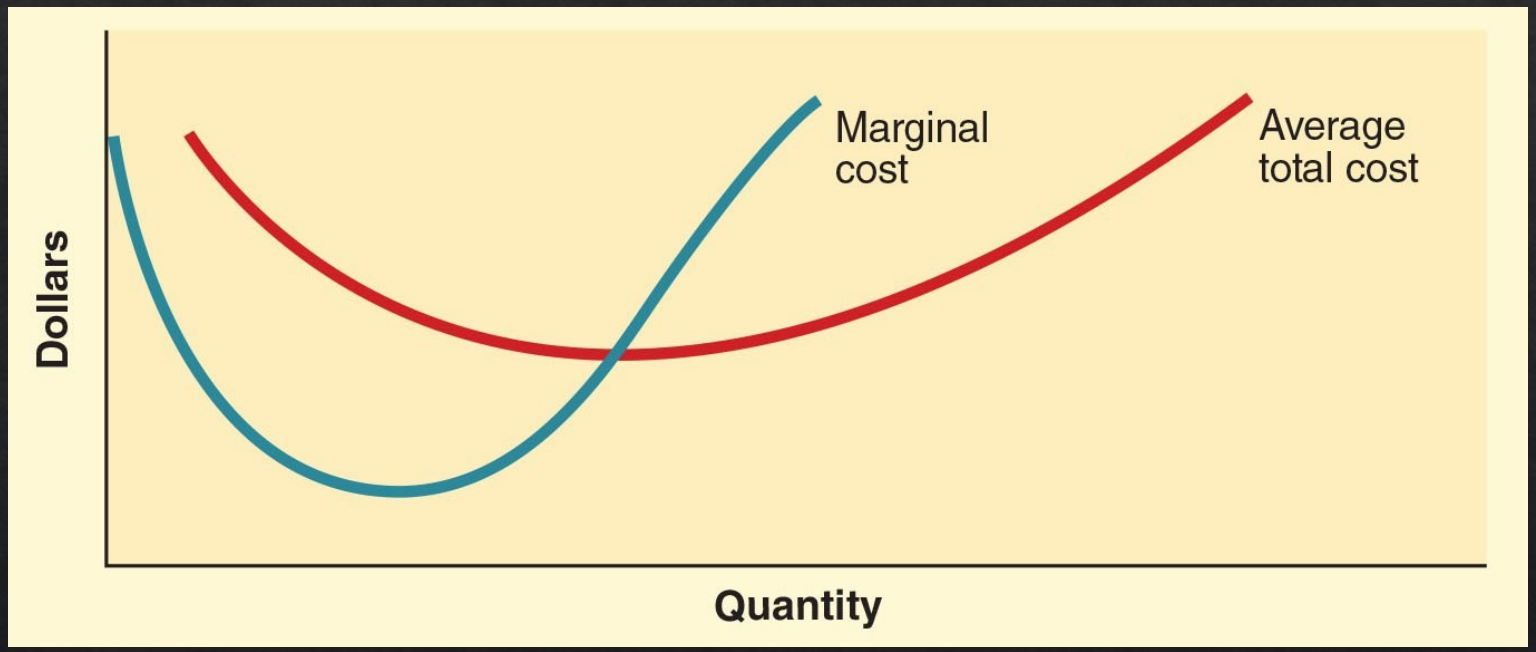

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Figure 12.5 - Typical Marginal Revenue and Average Revenue Relationship

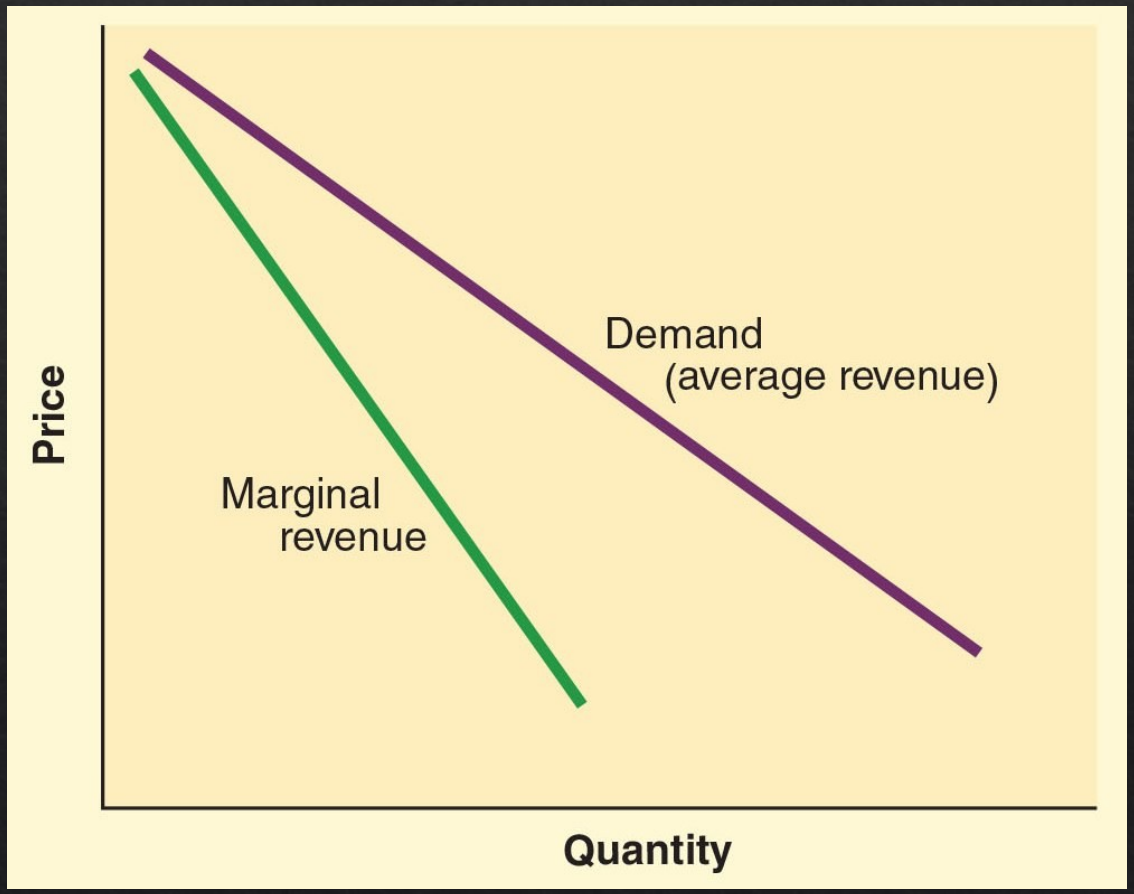

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Table 12.2 - Marginal Analysis Method for Determining the Most Profitable Price

1 Price	2 Quantity Sold	3 Total Revenue (1) × (2)	4 Marginal Revenue	5 Marginal Cost	6 Total Cost	7 Profit (3) – (6)
$57	1	$57	$57	$60	$60	$–3
50	2	100	43	10	70	30
38	3	114	14	2	72	42
33*	4	132	18	18	90	42
30	5	150	18	20	110	40
27	6	162	12	30	140	22
25	7	175	13	40	180	–5

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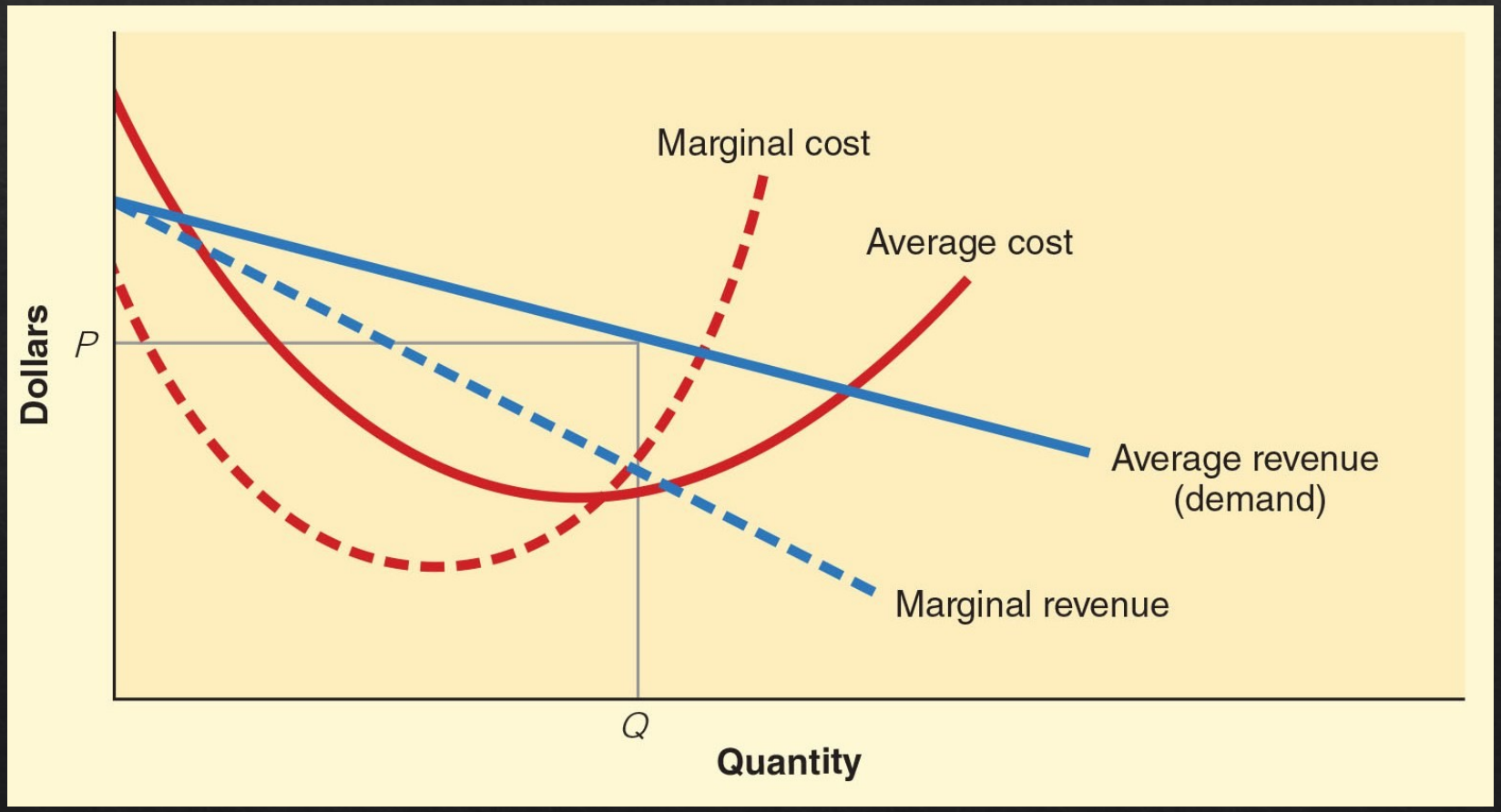
Figure 12.6 - Combining the Marginal Cost and Marginal Revenue Concepts



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Break-Even Analysis

- **Break-even point** – the point at which costs of producing a product equal the revenue made from selling the product
- Important in setting the price.
- Helps firm calculate time to recoup expenses at different price points

$$\text{break-even point} = \frac{\text{fixed costs}}{\text{per-unit contribution to fixed costs}}$$

$$= \frac{\text{fixed costs}}{\text{price} - \text{variable costs}}$$

$$= \frac{\$120{,}000}{\$40}$$

$$= 3{,}000 \text{ units}$$

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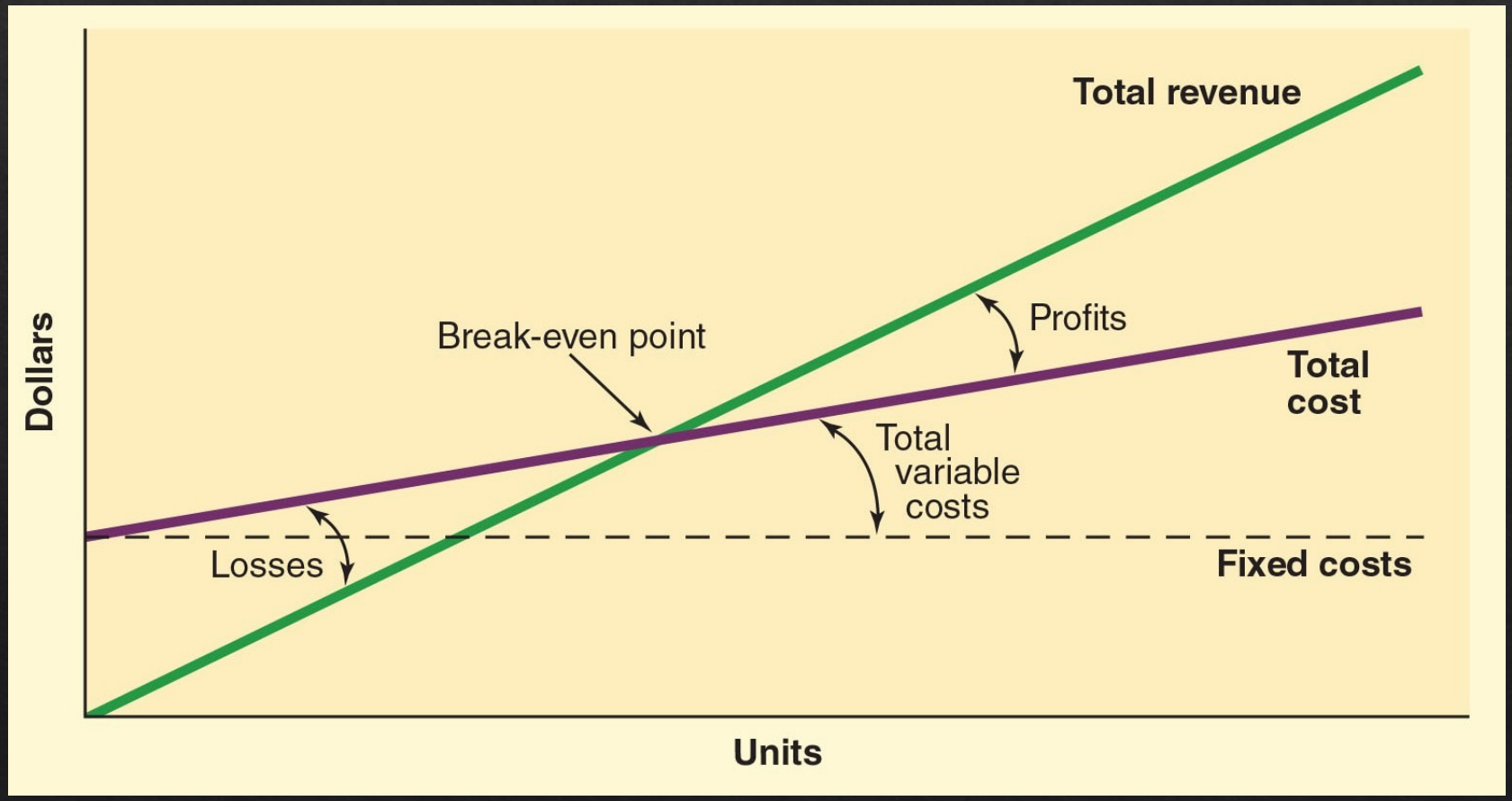
Figure 12.7 - Determining the Break-Even Point



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Break-Even Analysis (continued)

- Determine the break-even point for each of several alternative prices
  - Helps compare the relative effects on total revenue, total costs, and the break-even point
  - Helps identify highly undesirable prices that should definitely be avoided
- Can be used to determine whether and when a product will achieve a break-even volume

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Evaluation of Competitors' Prices

- Learn competitors' prices
  - Competitors' prices may be closely guarded.
  - Price lists may not show actual prices because of negotiation.
- Establish the firm's prices based on competitors' prices.
- Pricing above competition creates an exclusive image.
- Pricing below competition can increase market share.

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Selection of a Basis for Pricing

- Establishing prices involves selecting a basis for pricing
  - Cost and demand
  - Competition
- Appropriate pricing basis is affected by
  - Type of product
  - Market structure of the industry
  - Brand’s market share position relative to competing brands
  - Customer characteristics

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Cost-Based Pricing

- **Cost-based pricing** - adding a dollar amount or percentage to the cost of the product
- Cost-plus pricing – adding a specified dollar amount of percentage to the seller's cost
- Markup pricing – adding to the cost of the product a predetermined percentage of the cost

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Markup

Markup - predetermined percentage of the cost

$$\begin{aligned}\text{Markup as percentage of cost} &= \text{markup/cost}\\ &= 15/45\\ &= 33.3\%\\ \text{Markup as percentage of selling price} &= \text{markup/selling price}\\ &= 15/60\\ &= 25.0\%\end{aligned}$$

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Demand-Based and Competition-Based Pricing

Demand-based pricing – pricing based on the level of demand for the product

- Marketers estimate the quantity of product consumers will demand.
- The chosen price is based on demand.
- Effectiveness depends on accurate estimates.

Competition-based pricing – pricing influenced by competitors' prices

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Discussion Point – Demand-Based Pricing

Source: iStockphoto.com/DaveAlan

Airline companies engage in demand-based pricing. When demand for a specific flight is higher, the fares are higher, and when demand is lower, the fares will be lower.

When is the best time to book a flight?

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Selection of a Pricing Strategy

- Pricing strategy – a course of action designed to achieve pricing objectives
- Extent to which a business uses the pricing strategies depends on
  - Pricing and marketing objectives
  - Markets for its products
  - Degree of product differentiation
  - Product's life-cycle stage

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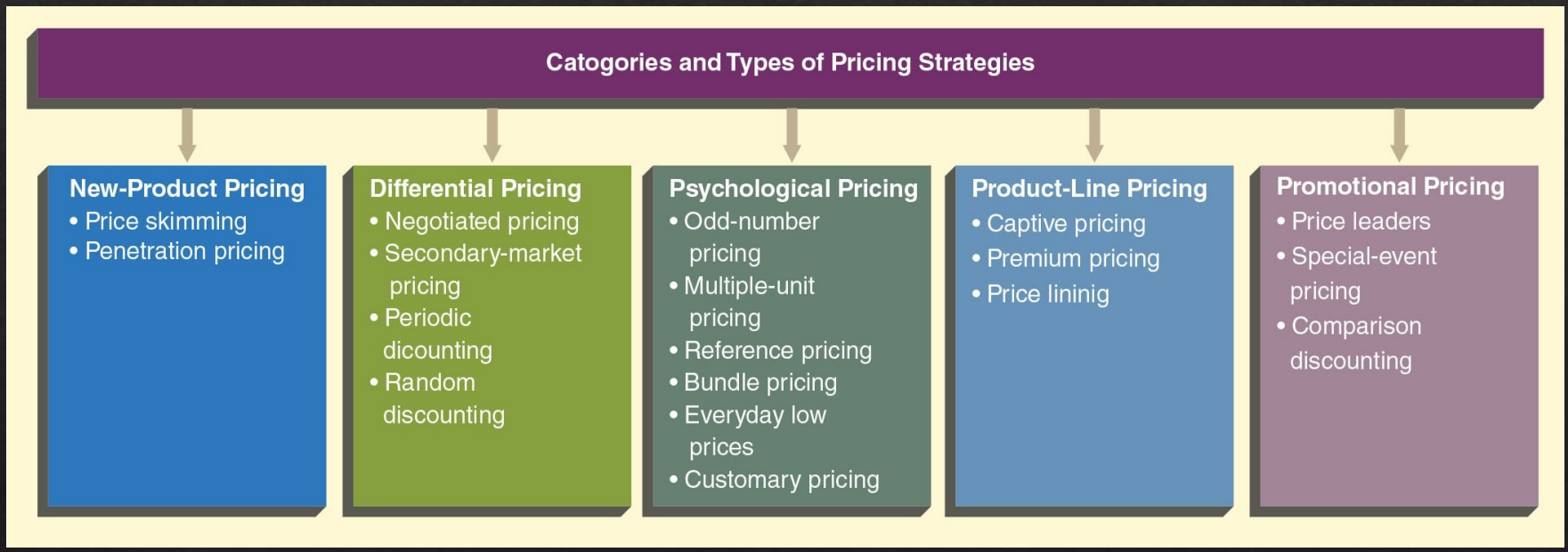
Figure 12.8 - Types of Pricing Strategies



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New-Product Pricing

- **Price skimming** – changing the highest possible price for a product during the introduction stage of its life cycle
- **Penetration pricing** – setting a low price for a new product

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Differential Pricing

- **Differential pricing** – charging different prices to different buyers for the same quality and quantity of product
- **Negotiated pricing** – establishing a final price through bargaining between seller and ustomer
- **Secondary-market pricing** – setting one price for the primary target market and a different price for another market
- **Periodic discounting** – temporary reduction of prices on a patterned or systematic basis
- **Random discounting pricing** – temporary reduction of prices or an unsystematic basis

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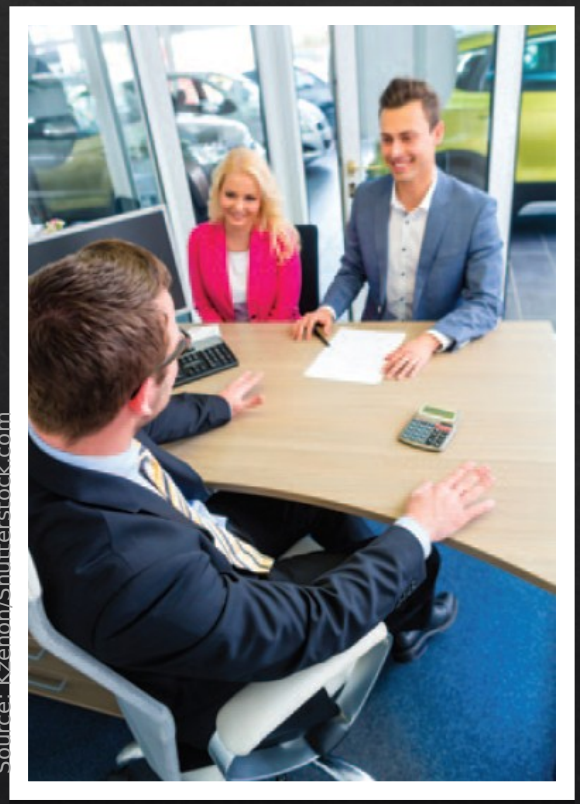
Discussion Point - Negotiated Pricing



Source: Kzenon/Shutterstock.com

Car buyers, such as the couple shown in this image, engage in negotiated pricing. It is understood that a buyer is not expected to pay the sticker price for a car.

Have you ever negotiated a price for purchasing a car? Did you get competitors' prices?

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Psychological Pricing

Psychological pricing encourages purchases based on consumers' emotional responses.

- **Odd-number pricing** – setting prices using odd numbers that are slightly below whole-dollar amounts
- **Multiple-unit pricing** – packaging together two or more units of a product and selling them at a single price

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Psychological Pricing (continued)

- **Reference pricing** – pricing a product at a moderate level and displaying it next to a more expensive model or brand
- **Bundle pricing** – packaging together two or more complementary products and selling them at a single price
- **Everyday low prices (EDLP)** – pricing products low on a consistent basis
- **Customary pricing** – pricing certain goods on the basis of tradition

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Discussion Point – Bundle Pricing

Source: iStockphoto.com/RiverNorthPhotography

Most providers of cable services engage in bundle pricing.

Does buying a bundled combination save you money?

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Discussion Point – Everyday Low Prices

Source: Barry Blackburn/Shutterstock.com

Walmart is a major user of the Everyday Low Price strategy.

Do you think you get good deals when you purchase EDLPs?

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Product-Line Pricing

- Product-line pricing - establishing and adjusting the prices of multiple products within a product line
- **Captive pricing** – pricing the basic product in a production line low, but pricing related items at a higher level
- **Premium pricing** – pricing the highest quality product or the most versatile and most desirable version of a product in a product line higher than other models in the product line
- **Price lining** – selling goods only at certain predetermined prices that reflect definite price breaks

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Discussion Point – Captive Pricing

Source: Boyan Dimitrov/Dreamstime.com

Companies that produce and market printers engage in captive pricing by charging high prices for replacement of ink cartridges. To continue using a specific printer, the customer must purchase additional ink cartridges.

What products do you own that require additional purchases with captive pricing?

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Promotional Pricing

- Price is often coordinated with promotion as a marketing mix.
- **Price leaders** – products priced below the usual markup, near cost, or below cost
- **Special-event pricing** – advertised sales or price cutting linked to a holiday, season, or event
- **Comparison discounting** – pricing of a product at a specific level and simultaneously comparing it to a higher price

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Determination of a Specific Price

- Pricing strategy - yields a certain price that may need refining
  - Helps in setting final price
  - Marketers may need to refine this price in order to make it consistent with circumstances
- In order to set prices, marketers must
  - Establish pricing objectives
  - Have considerable knowledge about target market customers
  - Determine demand, price elasticity, costs, and competitive factors

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Pricing for Business Markets

- Establishing prices for business markets differ from setting prices for consumers due to
  - Size of purchases
  - Transportation considerations
  - Geographic issues
- Types of pricing associated with business products
  - Geographic pricing
  - Transfer pricing
  - Discounting

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Geographic Pricing

- **Geographic pricing** - deals with delivery costs; reductions for transportation and other costs related to the physical distance between buyer and seller
- F.O.B. origin pricing - price of merchandise at the factory before shipment
- F.O.B. destination - price indicating the producer is absorbing shipping costs

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Transfer Pricing

- **Transfer pricing** - one unit in an organization sells a product to another unit
  - Determined by calculating the cost of the product
  - Cost varies depending on the types of costs included in the calculations
  - Choice of the costs to include when calculating the transfer price depends on
    - Company's management strategy
    - Nature of the units' interaction
- **Discount** – a deduction from the price of an item

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Table 12.3 - Discounts Used for Business Markets

Type	Reasons for Use	Examples
Trade (functional)	To attract and keep effective resellers by compensating them for performing certain functions, such as transportation, warehousing, selling, and providing credit.	A college bookstore pays about one-third less for a new textbook than the retail price a student pays.
Quantity	To encourage customers to buy large quantities when making purchases and, in the case of cumulative discounts, to encourage customer loyalty.	Numerous companies serving business markets allow a 2 percent discount if an account is paid within ten days.
Seasonal	To allow a marketer to use resources more efficiently by stimulating sales during off-peak periods.	Florida hotels provide companies holding national and regional sales meetings with deeply discounted accommodations during the summer months.
Allowance	In the case of a trade-in allowance, to assist the buyer in making the purchase and potentially earn a profit on the resale of used equipment. In the case of a promotional allowance, to ensure that dealers participate in advertising and sales support programs.	A farm equipment dealer takes a farmer's used tractor as a trade-in on a new one. Nabisco pays a promotional allowance to a supermarket for setting up and maintaining a large end-of-aisle display for a two-week period.

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